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15 July 1964

TO:

SUBJECT: Contracts BT-1943 and IK-4666 - The Determination of Percentage Completion and Derivation of Incentive Fee

In accordance with the GENERAL PROVISIONS, Clause 10.(3), (i) entitled TERMINATION, it is necessary to determine the physical percentage completion of the contract work. In addition, it is also necessary to determine the estimated costs for the completed portion of the work with which the "actuals" can be compared for the purpose of determining incentive fee debits or credits in accordance with the incentive fee formula.

Before discussing the details of the analysis for each contract, it is worthwhile to review several subjects discussed with you immediately following the terminations.

Contract BT-1943 was partially terminated to the extent that we were directed to complete the remaining units to have been delivered under that contract through final acceptance at Boston. Following this acceptance, the units were then to have been shipped to storage. In order to ease our administrative task, we stopped all labor charges against our internal cost center Project 9040 and established cost center Project 9099 to identify the costs associated with the continued portion of the work. From an analysis of the total work it became quite clear that a relatively insignificant amount of Itek's work remained to be accomplished under the total Contract. This minor amount of work remaining was the ruling factor in establishing our technique for presenting our analysis of the per cent complete.

Cost center Project 9093 was established for the collection of Termination Costs and cost center Project 9094 was established for the collection of Termination Settlement Expenses. If you will recall, there was some discussion as to our reasons for identifying these types of work/

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costs separately. I have enclosed as Attachments A and B a copy of each of the internal WORK AUTHORIZATION ORDERS which were issued as part of my internal direction for the accomplishment of the termination activities. These serve to define the different types of work involved. Single cost centers for Termination Costs and Termination Settlement Expenses would be the more efficient way to treat such expenses considering administrative ease. The reasons for this decision are the relatively minor amount of work which would not be accomplished under Contract BT-1943 and, more importantly, that any residual inventory from that contract was to have been transferred in total for accountability under Contract IK-4666. An additional reason was that it would be difficult to derive an equitable formula for the distribution of such costs between the two contracts without being somewhat arbitrary.

Another subject to which we devoted some time was our intention to apply full burdens to our Termination Cost activities as opposed to the Termination Settlement Expenses which would not bear burdens. As a premise for this discussion, it was stated that the course of direction which we proposed in this respect required your agreement at that time since our alternative to the "full burdens" approach would be to direct all persons engaged in the termination activities (including "indirect" personnel) to charge their proper termination account and not apply burdens to any labor or material. More importantly, once any direction had been issued, it would be impossible to reasonably, let alone accurately, reconstruct the proper charges if subsequent changes were necessary.

In presenting our reasons for full burdens, we cited the fact that this technique had been used in the accomplishment of the termination of a major subcontract which was terminated for convenience 8 December 1961. Since almost two years had elapsed from that time until the termination of the LANYARD Program (late October 1963), we felt that this technique appeared valid since we had not been apprised of its unacceptability by any organization that was involved in the settlement of our claim for the program. However, regardless of this reason, it is my conviction that the nature of the work being performed as a result of your formal termination for convenience is no different from the nature of the work we would have accomplished in the event the contracts had been allowed to terminate naturally at completion.

In our cost estimates and negotiations for these contracts, we made clear that there were provisions for work to be accomplished following the shipment of the last piece of hardware from Boston. This is evidenced by our applying some six to eight weeks of minimum manpower beyond that point for the purposes of prudently identifying our residual inventory, the orderly disposition of paper work (both classified and unclassified), the orderly closing of our security document control files, the anticipation of disposing of the residual inventory in accordance with

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instructions we would have received from you, the preparation for shipment of the inventory, and the orderly closing of our outstanding commitments, establishment of appropriate burdens for the fiscal periods in consideration, the preparation and submission of our final invoices and other accounting and administrative responsibilities which were expected of us as a responsible contractor.

In determining the accounting techniques to be used for the purposes of that work, it is considered normal accounting practice to expect "direct" personnel to charge "directly" and "indirect" personnel to charge "indirectly" in the accomplishment of these tasks. That is to say, that no unusual accounting practices were contemplated.

Termination Settlement Expenses are, by definition, the direct result of the unusual circumstances of a formal termination of the contract prior to its completion. More specifically, it requires that our purchasing department take unusual measures in stopping the work of our second tier subcontractors and vendors and then analyzing and negotiating settlements that are fair and reasonable reimbursement for the work completed by those subcontractors. Further, it places an unusual demand on our contracts and other administrative personnel to prepare and analyze our position relating to percentage completion and the submission and negotiation of our settlement claim. We recognize these as unusual requirements and, for this reason, agree that such expenses incurred by normally "indirect" personnel should, by definition, not bear burdens.

Therefore, it has been determined that the nature of the work performed under our Termination Cost account is no different from that which would have been performed had the contract not been terminated. It has also been determined that the work performed under Termination Settlement Expense is unusual work directly resulting from the termination. Any discussion of the Termination Cost work must then relate to the magnitude of the work resulting from termination as opposed to the nature of the work. We recognize that the magnitude is significantly greater since our "material in process" is greatly in excess of the residual inventory had the equipment been delivered complete. In inventorying and preparing for disposition of this material, we must then recognize that certain of our personnel must be retained beyond the time that they would have been required and were not, therefore, available for transfer to other programs within the company which could have better utilized their talents in the accomplishment of fee-bearing work. In the instance of this termination, our job was made more complicated because the termination of Contract BT-1943 was partial and deterred us from accomplishing a total termination inventory until the last of the equipments were, in fact, shipped from Boston.

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As a result of the completion of all termination activities 15 July 1964, we have enclosed our final invoices for your review, approval, and payment. Our cost invoices have been prepared to include a summary cost statement for each of the contracts. Beneath each summary sheet is a supporting cost statement for each fiscal period by internal project phase. Our direct labor dollars and material expenses have been taken directly from our books of account. We have included a reserve for our outstanding commitments which have been specifically identified as a result of an exhaustive review of our liabilities to each of our subcontractors. To these direct labor and material expenses, we have applied burdens which we believe are consistent with a similarly thorough review of our burden centers. These rates include provisions for the Independent Research and Development portion of those expenses which are not applicable to cost type contracts in accordance with our agreement with Boston Air Procurement District. This provision accounts for the major difference between the rates used and our "actual" rates which we have or expect to experience in each of the fiscal periods. We trust that we will be able to review the derivation of these rates with you and reach agreement in order that our invoices may be cleared promptly to allow complete settlement of these contracts. We make this request realizing that our fiscal 1964 rates, at least, will not be negotiated with the Boston Air Procurement District for several months hence.

Our fee invoices request payment of fee dollars which were derived by Attachments C and D. These attachments are detailed analyses of the physical/fiscal percentage completion. The explanations of the derivations of these calculations are contained within each attachment.

Also enclosed are the various releases submitted in accordance with the GENERAL PROVISIONS which concern themselves with patents, future claims, etc.

We understand that you will desire some period of time to analyse this presentation. However, our personnel will be available to meet and discuss with you any portions of the submission which may require further explanation.

Very truly yours,

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Itek Corporation

[redacted]

DJ:njv
Attachments - A,B,C,D

cc: [redacted] 3 w/3 each
1 w/1 each
2 w/2 each

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